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SUPREME COURT, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

D.C. TRANSIT SYSTEM, INC.

Petitioner,

v.

WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION, *et al.*,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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December 13, 1988

Questions Presented

1. Whether depriving a public utility of its property by retroactive invalidation of unchallenged rate increases violates established precedents of this Court and due process principles?

2. Whether depriving a public utility of the increase in the value of non-depreciable property violates established precedents of this Court and due process principles?

3. Whether depriving a public utility of the market value of its property at the moment the property is first devoted to public service violates established precedents of this Court and due process principles?

RULE 28.1 LISTING

The following are parents, subsidiaries (except wholly owned subsidiaries) or affiliates of petitioner D.C. Transit System, Inc.:

D.C. Trading and Development Corp.

D.C. Realty and Development Corp.

DCTECH Research Centers, Inc.

Trans Carib Air, Inc.

RULE 21.1(B) LIST OF PARTIES

The petitioner is D.C. Transit System, Inc. The respondents are:

Washington Metropolitan Area Transit Commission

Democratic Central Committee of the District of Columbia

Leonard N. Bebchick

Black United Front

Washington Area Construction Industry Task Force

District of Columbia

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Petitioner,

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WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION, et al.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Petitioner D.C. Transit System, Inc. ("Transit") respectfully prays that a writ of certiorari issue to review the judgment and mandate of the United States Court of Appeals for the District of Columbia Circuit (the "Court of Appeals") entered in this proceeding on September 14, 1988.

Opinions Below

The report of the Washington Metropolitan Area Transit Commission (the "Commission") Hearing Officer is unreported and appears in the Appendix at A1-A133. The decision of the Commission substantially adopting the Hearing Officer's Report is also unreported and appears in the Appendix at A134-A180. The opinion of the Court of Appeals is reported at 842 F.2d 402 (D.C. Cir. 1988) and appears in the Appendix at A181-A252. The orders of the Court of Appeals denying Transit's petition for rehearing and suggestion for rehearing *en banc* are unreported and appear in the Appendix at A486-A487.

Jurisdiction

The judgment and mandate of the Court of Appeals was entered on September 14, 1988. This petition for certiorari is filed within 90 days of that date. Jurisdiction is invoked under 28 U.S.C. § 1254(1).

Constitutional Provisions, Statutes and Code Provisions Involved

The Fifth Amendment to the United States Constitution provides in pertinent part:

> nor [shall any person] be deprived of . . . property, without due process of law; nor shall private property be taken for public use, without just compensation.

The Franchise Act, Pub. L. No. 84-757, § 4, 70 Stat. 598 (1956) provides:

> It is hereby declared as a matter of legislative policy that in order to assure the Washington Metropolitan Area of an adequate transportation system operating as a private enterprise, the Corporation, should be afforded the opportunity of earning such return as to make the Corporation an attractive investment to private investors.
>
> * * *
>
> It is further declared as a matter of legislative policy that if the Corporation does provide the Washington Metropolitan Area with a good public transportation system, with reasonable rates, the Congress will maintain a continuing interest in the welfare of the Corporation and its investors.

Section 5 of the Franchise Act provides in relevant part:

> The initial schedule of rates . . . shall continue in effect until August 15, 1957, and thereafter until superseded . . . . Whenever on or after August 15, 1957, the Corporation files with the Commission a new schedule of rates, such new schedule shall become effective on the tenth day after the date of such filing, unless . . . the Commission suspends the operation of such new schedule . . . . If the Commission suspends such new schedule it shall immediately give notice of a hearing . . . and, after such hearing . . . shall determine and by order fix the schedule of rates to be charged by the Corporation. If the Commission does not enter an order, to take effect at or prior to the end of the period of suspension . . . the suspended schedule filed by the Corporation may be put into effect by the end of such period, and shall remain in effect until the Commission has issued an appropriate order based on such proceeding.

70 Stat. at 599.

The Washington Metropolitan Area Transit Regulation Compact, tit. II, art. XII, § 6(a)(4), incorporated into Pub. L. No. 86-794, 74 Stat. 1031 (1960) provides in relevant part:

> It is hereby declared as a matter of legislative policy that in order to assure the Metropolitan District of an adequate transportation system operating as private enterprises the carriers therein, in accordance with standards and rules prescribed by the Commission, should be afforded the opportunity of earning such return as to make the carriers attractive investments to private investors. As an incident thereto, the opportunity to earn a return of a least 6½ per centum net after

> all taxes properly chargeable to transportation operations, including but not limited to income taxes, on gross operating revenues, shall not be considered unreasonable.

74 Stat. at 1040-41.

D.C. Code § 43-702 (1967) (codified in 1981 as §§ 43-901 and 43-902) provided in relevant part:

> All public utilities to which an order of the Commission applies shall make such changes in their schedules on file as may be necessary to make the same conform to said order, and no change shall thereafter be made by any public utility in any such rates, tolls, or charges, or in any joint rate or rates, without the approval of the Commission. Certified copies of all other orders of the Commission shall be delivered to the public utility affected thereby in like manner, and the same shall take effect within such reasonable time thereafter as the Commission shall prescribe.
>
> * * *
>
> The Commission may, at any time, upon notice to the public utility and after opportunity to be heard . . . rescind, alter, or amend any order fixing any rate or rates, tolls, charges, or schedules, or any other order made by the Commission, and certified copies of the same shall be served and take effect as herein provided for original orders.

D.C. Code § 43-703 (1967) (codified in 1981 as § 43-903) provided in relevant part:

> All rates, tolls, charges, time and condition of payment thereof, schedules, and joint rates fixed by the commission shall be in force and shall be prima facie reasonable until finally found otherwise in an action brought for that purpose.

D.C. Code § 12-301 (1981) provides in relevant part:

> Except as otherwise specifically provided by law, actions for the following purposes may not be brought after the expiration of the period specified below from the time the right to maintain the action accrues. . . .
>
> (8) for which a limitation is not otherwise specifically prescribed—three years. . . .

Statement of the Case

In 1956, Congress granted Transit an exclusive 20-year franchise to provide a mass transportation system in the District of Columbia and its environs conditioned upon Transit acquiring the assets of Capital Transit Company ("Capital") which had served the area's mass transportation needs for many years.[1] Accordingly, at 11:55 p.m. on August 14, 1956, Transit acquired all of Capital's assets and at 11:59 p.m. on August 14, 1956, Transit commenced operating the system. The assets had a net book value on Capital's books of approximately $23,880,000. Transit paid $13,540,000 for all of Capital's assets and assumed Capital's financial obligations. At the time Transit obtained its franchise, the Franchise Act and subsequently the Washington Metropolitan Area Transit Regulation Compact (the "Compact"), under which Transit subsequently operated, specifically provided that investors in Transit, having taken a risk of loss, were entitled to recover a reasonable return on their investment.[2]

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[1] Franchise Act, Pub. L. No. 84-757, § 2, 70 Stat. 598 (1956). The term of the franchise was abbreviated in 1973 when Congress transferred the responsibility to a public authority. National Area Transit Act of 1972, Pub. L. No. 92-517, 86 Stat. 999 (1972).

[2] *Washington Metropolitan Area Transit Regulation Compact*, tit. II, Art. XII, § 6(a)(4), *incorporated into* Pub. L. No. 86-794, 74 Stat. 1031 (1960); Franchise Act, Pub. L. No. 84-757, § 4, 70 Stat. 598 (1956).

Prior to January 26, 1968, basic rates for mass transportation in the District of Columbia had been set at a cash fare of twenty-five cents and a token fare of four for ninety-eight cents. On January 26, 1968, the Commission issued Order No. 773 and granted Transit a fare increase to make up a deficiency in the revenues necessary to insure Transit's investors a reasonable rate of return.[3] Between January 26, 1986 and June 26, 1970, the Commission issued at least four additional and independent orders granting similar fare increases to Transit: Order Nos. 882[4], 900[5], 984[6] and 1052[7]. While farepayer challenges were brought against Order Nos. 773 and 1052, no farepayer challenges were *ever* brought against intervening rate Order Nos. 882, 900 and 984.

In *Democratic Central Committee v. Washington Metropolitan Area Transit Commission*, 485 F.2d 786, 789-90 (D.C. Cir. 1973), *cert. denied*, 415 U.S. 935 (1974) (hereinafter *"DCC-I"*) and *Democratic Central Committee v. Washington Metropolitan Area Transit Commission*, 485 F.2d 886 (D.C. Cir. 1973), *cert. denied*, 415 U.S. 935 (1974) (hereinafter *"DCC-II"*), the Court of Appeals reviewed Order Nos. 773 and 1052, invalidated the fare increases and held that Transit's riders were entitled to restitution for fare overcharges.[8] Specifically, the Court of Appeals found that Order Nos. 773 and 1052 were defective because the Commission had not considered the extent to which appreciation in the value

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[3] 72 P.U.R.3d 113, 158 (WMATC 1968) (A253-A331).

[4] On October 29, 1968, the Commission issued Order No. 882. The order is unreported but is included in the Appendix at A332-A349.

[5] On December 23, 1968, the Commission issued Order No. 900. The order is unreported but is included in the Appendix at A350-A364.

[6] 81 P.U.R.3d 417 (WMATC 1969) (A365-A433).

[7] 85 P.U.R.3d 1 (WMATC 1970) (A434-A485).

[8] *DCC-II*,485 F.2d at 915; *DCC-I*, 485 F.2d at 829.

of Transit's properties (both depreciable and non-depreciable) might have obviated the need to generate additional revenue through fare increases.[9] The Court of Appeals held that Transit's farepayers were entitled to restitution of the appreciation in value of in-service properties subsequently converted to non-operating status.[10] The Court of Appeals remanded the fare order challenges to the Commission for determination of the amounts, if any, of appreciation in the value of Transit's properties and for computation of any restitution award resulting therefrom.[11] The issues raised in this petition arise out of disputes between the parties over the use by the Commission of calculation methods which violate prior decisions of this Court and fundamental due process principles.

In the remand proceedings concerning Order No. 773, Transit argued that any farepayer recovery from the net gain on properties was limited to the amount of the increased fares collected under Order No. 773 during the 277 days it was in effect. In rejecting Transit's argument, the Commission found that "Order No. 773 was the base fare" and "foundation" for all future rate or-

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[9] *DCC-II*, 485 F.2d at 898-902; *DCC-I*, 485 F.2d at 822.

[10] *DCC-II*, 485 F.2d at 913-914; *DCC-I*, 485 F.2d at 822, 827. As the Court of Appeals recognized, the rationale of these decisions was that any gain in the value of an in-service property should have inured to the farepayers' benefit on the date that property was removed from operation. A189. *DCC-II*, 485 F.2d at 898-902; *DCC-I*, 485 F.2d at 822.

[11] In *DCC-II*, the Court of Appeals also concluded that the Commission did not discharge its duty to consider efficiency and viability when issuing a new fare through Order No. 1052. 485 F.2d at 913. The Court of Appeals directed the Commission to examine whether Transit was efficiently managed and viable in 1970. Upon remand, the Commission concluded that at the time of the 1970 fare elevation, Transit was efficiently managed and viable. A186. The Court of Appeals affirmed the Commission's findings. A185-A188. No issue is raised in this petition concerning the efficiency and viability issues.

ders and that Order Nos. 882, 984 and 1052 were merely "incremental" to Order 773. A159. Accordingly, the Commission measured the limits of restitution by "the annual level of revenue increase authorized in Order No. 773 multiplied by the number of years that Transit continued utility operations" under subsequent orders. A158.

On remand, the Commission measured the appreciation in value by comparing the *book value* of the property on the date the property was first devoted to operating service with the property's market value on the date the property was removed from operating service. Hence, the Commission used a "book-to-market"[12] approach rather than the "market-to-market"[13] approach urged by Transit. Transit took exception to the "book-to-market" approach and contended that appreciation should have been calculated by subtracting the *market value* of the property when devoted to public service from the market value when the property was removed from operating service. Otherwise, Transit argued, Transit's investors would be deprived of part ($4,141,771) of the value of their properties at the time the properties were first devoted to public service. The Commission remained steadfast in using a "book-to-market approach" despite specifically conceding that its approach did confiscate the property interests of Transit's investors. A141-A142.

On appeal to the Court of Appeals, Transit raised many issues concerning the computation of restitution and specifically raised the issues described above. Tran-

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[12] This method involves calculation of the gain by subtracting the cost or book value of the property when it was placed in service from its market value when it was taken out of service.

[13] This method uses market value of the property as the subtrahend rather than the cost or book value.

sit first argued that restitution should have been limited to the aggregate of excess fares collected during the period in which the invalid fare increase under Order No. 773 was in effect. Transit argued that since Order No. 773 was superseded by rate orders that were *never* challenged by farepayers, the Commission engaged in retroactive ratemaking by retroactively invalidating presumptively valid rate orders subsequent to Order No. 773. Such actions, Transit argued, deprived Transit of its property without due process of law, in violation of prior decisions of this Court.

Transit also argued before the Court of Appeals that the gain on non-depreciable property was improperly attributed by the Commission to the farepayers rather than Transit's investors and that such action resulted in an unconstitutional confiscation of Transit's property in violation of prior decisions of this Court.

In addition, Transit contended before the Court of Appeals, that in calculating gain allocable to farepayers, the Commission should have employed the "market-to-market" method of computing property appreciation rather than the "book-to-market" method. Transit argued that because the market value of the properties on August 14, 1956 exceeded their booked cost to Transit on that date by $4,141,771, the "book-to-market" method deprived Transit and its investors of that part of the value of their properties at the time they were first devoted to public service.

The Court of Appeals rejected all of Transit's arguments insofar as they relate to the issues raised in this petition. In an opinion written by Chief Judge Robinson, the Court of Appeals upheld the Commission's determination that the maximum amount of restitution would be the fare increment authorized by Order No. 773 over the remainder of Transit's life as a public utility. A208-

A209. In addition, the Court of Appeals concluded that the farepayers rather than Transit's investors were entitled to receive the benefit of the gain on Transit's non-depreciable properties. Finally, the Court of Appeals upheld the Commission's use of the "book-to-market" formula. A198-A199.

Judge MacKinnon filed a vigorous dissent in which he expressed his agreement with Transit's arguments as raised in this petition. Specifically, Judge MacKinnon found that the Commission had violated basic principles of public utility regulation and the express statutory language of the Compact by allocating to farepayers rather than Transit's investors the gain on non-depreciable assets when transferred out of service. A226-A231. In addition, Judge MacKinnon concluded that by not limiting the restitutionary period to the 277 days that Order No. 773 was in effect, the Commission, with the Majority opinion's blessing, was engaging in unlawful retroactive ratemaking. A231-A250. Finding that the Commission's "base fare" rationale constituted "an untimely, outlawed and unprecedented departure from the statutory presumption of reasonableness and validity that accompanies duly adopted rate orders", Judge MacKinnon accused the Majority of engaging in "*post hoc* rationalization." A249. Judge MacKinnon also expressed the view that the use of Transit's "market-to-market" method of calculating gain allocable to the farepayers "may better accord with investors' entitlement to the benefit of their bargain" and also represented "a better approximation of real value, since book value is usually a poor indicator of an item's worth." A230.

Upon issuance of the Court of Appeals decision, Transit applied for a rehearing and suggested that the court hear the appeal *en banc*. On September 14, 1988,

the Court of Appeals denied Transit's petition for rehearing and suggestion for rehearing *en banc*. A486-A487. Accordingly, Transit filed the instant petition.

Reasons for Granting the Writ

The instant petition raises issues of crucial importance in maintaining the integrity of administrative decision-making and the delicate balance between the rights of utility shareholders and the public. In reviewing the Commission's calculation of restitution, the Court of Appeals turned its back on basic due process concerns, administrative law principles and settled judicial precedent of this Court. In so doing, the Court of Appeals breathes dangerous uncertainty into the ratemaking process and increases the risk to both public utilities and their investors. Judicial intervention by this Court is essential to alleviate such inherent dangers.

In calculating the appropriate amount of restitution to be paid by Transit, the Commission did not limit itself to the fare increase declared invalid under Order No. 773. Instead, in absolute disregard of due process principles, the Commission retroactively invalidated subsequent valid rate orders which had *never* been challenged by farepayers and ordered restitution of the fare increases granted by such orders. The Commission's action violated the clear proscription against retroactive ratemaking recognized by this Court and the regulatory scheme in force for the District of Columbia.

The compelled restitution of fares collected under valid rate orders threatens both the integrity of the administrative process and the ability of the public to place reliance upon administrative actions. Utility companies such as Transit could neither raise capital, budget expenses, nor plan for growth if historic rates validly promulgated were subject to second-thoughts and post-hoc

rationalizations several years later. If utility companies can not rely on the valid rates issued through the administrative process, the entire regulatory structure necessarily collapses. The Court of Appeals magnifies these threats by placing a judicial imprimatur on the Commission's unprincipled restitution award.

The Commission's adoption of an inappropriate method of computing restitution as to non-depreciable properties also raises serious regulatory concerns. The method adopted by the Court of Appeals violates established precedent of this Court and contravenes fundamental utility regulation principles. The Court of Appeals effectively has fashioned a sweeping new principle of ratemaking, and has brushed aside numerous final administrative and judicial decrees directly contrary to this new rule. Strikingly, the Court of Appeals now applies this new rule to deny property appreciation earned as early as 1958.

By refusing to recognize Transit's investors' right to own the increase in value of non-depreciable property transferred out of public service, the Commission and Court of Appeals set a dangerous precedent that will serve to greatly discourage investment in public utility stock. If the opinion below is permitted to stand, potential utility investors and creditors will be compelled to assume not only the risk that the "rules of the game" at the time of their investment may not have continuing application in the future, but also the risk that the financial picture of the utility at the time of their investment is subject to complete recalculation some time in the unlimited future. That new element of uncertainty injected by the court into utility investment will be immediately and directly reflected in higher costs for utility capital and credit.

Finally, absent action by this Court, the precedent of using "book-to-market" calculations of fare restitution will send a signal to administrative agency decision-makers that deprivation of property without due process is acceptable. Such a signal would have disastrous consequences.

I.

The Court of Appeals Abandoned Principles of Due Process by Upholding Retroactive Ratemaking

The Commission's actions in fashioning the time period for restitution of increased fares under Order No. 773 clearly amounted to retroactive ratemaking without due process. The Commission erroneously determined that the maximum amount of restitution allowable in *DCC-I* was the fare increase authorized by Order No. 773 "over the remainder of Transit's life as a public utility." That "life", of course, included the years after October 29, 1968, when valid and unchallenged rates superseding Order No. 773 were in effect.[14] 485 F.2d at 823-24. The inclusion in the restitutionary award of any fares earned after Order No. 773 was superseded by subsequent valid rate orders is tantamount to invalidating the valid rate orders retroactively. By upholding this arbitrary action, the Court of Appeals impermissibly extended its jurisdiction to the review of rate orders which were never challenged before the Commission or the courts. Such results should not be allowed to stand because they show "that the limits of due process have been overstepped." *Fed. Power Comm'n v. Natural Gas Pipeline Co.*, 315 U.S. 575, 586 (1942).

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[14] WMATC Order No. 882, dated October 29, 1968, granted a fare increase to Transit and created a new fare schedule superseding Order No. 773. A332-A349.

A. Retroactive Ratemaking Violates Precedent Of This Court

By upholding the restitutionary award in this case, the Court of Appeals has abandoned the long-standing rule against retroactive ratemaking which this Court has espoused since 1926. *Bd. of Pub. Util. Comm'rs v. New York Tel. Co.*, 271 U.S. 23, 32 (1926) ("Profits of the past cannot be used to sustain confiscatory rates for the future."). More recently, this Court restated that rule in *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571 (1981):

> Not only do the courts lack authority to impose a different rate than the one approved by the Commission, but the Commission itself has no power to alter a rate retroactively. . . . This rule bars "the Commission's retroactive substitution of an unreasonably high or low rate with a just and reasonable rate."

Id. at 578 (quoting *City of Piqua v. F.E.R.C.*, 610 F.2d 950, 954 (D.C. Cir. 1979)).[15] For decades, this Court and lower courts have consistently opposed retroactive ratemaking. *U.S. v. Morgan*, 307 U.S. 183, 192 (1939); *Arizona Grocery Co. v. Atchison, T & S.F. Ry.*, 284 U.S. 370, 390 (1932) (where Commission has approved the maximum reasonable rate carrier may charge, it may not later require carrier that adhered to the established rules to pay reparations measured by what Commission now determines it should have decided earlier to be a reasonable rate); *A.T.&T. Co. v. F.C.C.*, 836 F.2d 1386, 1394 (D.C. Cir. 1988) (Starr, J., concurring); *Sea Robin*

[15] The fact that the Court of Appeals chose to ignore this rule in the present action is especially troubling in light of the fact that just five months after its decision here, it expressly relied on the "well-established prohibition against retroactive ratemaking" in *Alabama Power Co. v. I.C.C.*, 852 F.2d 1361, 1373 (D.C. Cir. 1988).

Pipeline Co. v. F.E.R.C., 795 F.2d 182, 189 n.7 (D.C. Cir. 1986) ("FERC may not order a retroactive refund based on a *post hoc* determination of the illegality of a filed rate's prescription."); *S. California Edison Co. v. F.E.R.C.*, 805 F.2d 1068, 1070 (D.C. Cir. 1986); *City of Piqua v. F.E.R.C.*, 610 F.2d at 954; *Nader v. F.C.C.*, 520 F.2d 182, 202 (D.C. Cir. 1975) (rule against retroactivity is a "cardinal principal of ratemaking"); *Washington Gas Light Co. v. Baker*, 188 F.2d 11, 21 (D.C. Cir. 1950), *cert. denied*, 340 U.S. 952 (1951).[16] It is simply unfathomable that the Court of Appeals chose to ignore this longstanding rule in the present action.

B. Retroactive Ratemaking Contravenes The Applicable Statutory Scheme

The Court of Appeals' retroactive invalidation of valid rate orders subsequent to Order No. 773 stands in direct contravention of the entire legislative and statutory scheme of Congress and the District of Columbia mandating that ratemaking be prospective and that rates be accepted as valid absent a challenge conducted in strict accordance with the requirements of due process. The Commission's obvious side-stepping of these important mandates, coupled with the Court of Appeals' explicit approval of such actions, plainly constitutes a denial of due process to Transit in this case.

The Congressional Act which granted Transit its franchise to operate a mass transportation system in the Washington Metropolitan Area specifically provided that

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[16] State law cases and statutes mirror federal opposition to retroactive ratemaking. *See, e.g., Potomac Elec. Power Co. v. Pub. Serv. Comm'n*, 380 A.2d 126, 148 (D.C. 1977), *cert. denied*, 444 U.S. 926 (1979) (commission cannot give "perpetual legal effect" to an unlawful order); *Washington Gas Light Co. v. Pub. Serv. Comm'n*, 452 A.2d 375, 379, 382-83 (D.C. 1982), *cert. denied*, 462 U.S. 1107 (1983); *Commonwealth v. Old Dominion Power Co.*, 184 Va. 6, 34 S.E.2d 364, *cert. denied*, 326 U.S. 760 (1945).

the initial schedule of rates would continue in effect "until superseded" and that upon the filing of a new schedule of rates, "such new schedule shall become effective on the tenth day *after*" the date Transit files such new rates with the Commission. Franchise Act, 70 Stat. at 599 (emphasis added). Similarly, D.C. Code § 43-702 (1967) specifically provided that public utilities changing their schedules of rates on file with the Commission could do so only with "the approval of the Commission" and that such rates "shall take effect within such reasonable time *thereafter* as the Commission shall prescribe." D.C. Code § 43-901 (1981) (codifying D.C. Code § 43-702 (1967) (emphasis added). The statutory scheme thus contemplated *prospective* ratemaking.

With respect to the specific procedure required under the statutory scheme to rescind or modify any rate order such as the rate orders retroactively invalidated in this case, D.C. Code § 43-702 (1967) specifically provided:

> The Commission may, at any time, *upon notice to the public utility and after opportunity to be heard* . . . rescind, alter, or amend any order fixing any rate or rates, tolls, charges, or schedules, or any other order made by the Commission, and certified copies of the same shall be served and take effect as herein provided for original orders.

D.C. Code § 43-902 (1981) (codifying D.C. Code § 43-702 (1967)) (emphasis added). The D.C. Code also specifically provided that Commission rate orders were presumptively reasonable and remained in force until specifically challenged in an action brought for that purpose:

> All rates, tolls, charges, time and condition of payment thereof, schedules, and joint rates fixed by the Commission shall be in force and shall be

> *prima facie reasonable until finally found otherwise in an action brought for that purpose.*

D.C. Code § 43-903 (1981) (codifying D.C. Code § 43-703 (1967)) (emphasis added). *See also* D.C. Code § 12-301 (1981) (statute of limitations for challenges to a rate must be brought within three years); *United States v. Pub. Util. Comm'n*, 158 F.2d 533, 537-38 (D.C. Cir. 1946), *cert. denied*, 331 U.S. 816 (1947) (rate orders become "conclusive when no person affected thereby avail[s] himself of the right of appeal"—such order cannot be retroactively "brand[ed]. . . as illegal"); *Commonwealth v. Old Dominion Power Co.*, 184 Va. 6, 34 S.E.2d 364, *cert. denied*, 326 U.S. 760 (1945) (applying laws similar to D.C. Code provisions and finding statutes designed to fix rates prospectively rather than retroactively).

Taken together, these provisions offer a clear statutory directive that rate increases become effective "after" issuance of Commission orders authorizing them and cannot be revised without a due process hearing. The rate orders issued between Order No. 773 and Order No. 1052 (i.e. Nos. 882, 900 and 984) were *never* challenged "in an action" or invalidated or revised through a notice and comment hearing as required under D.C. Code § 43-702. Accordingly, each of those orders must be deemed valid for the entire period during which they were in effect. The Court of Appeals and the Commission ignored this statutory presumption of reasonableness, and in its place, applied a *de facto* presumption of unreasonableness based on the prior—and essentially unrelated—invalidation of Order No. 773. Restitution in this case should have been awarded only for overcharges received during the period that Order No. 773 was in effect, *i.e.*, until it was superseded by Order No. 882 on October 29, 1968.

Neither the Court of Appeals nor the Commission had the power to give "perpetual legal effect" to invalid rate Order No. 773 and ignore subsequent rate orders (Nos. 882, 900 and 984) issued through the administrative process with proper notice and hearing.[17] Quite the contrary, each successive rate order is properly understood as an *independent* expert prediction, based on all relevant facts and circumstances, as to the fare necessary to guarantee the utility a reasonable rate of return. A332-A485. The Court of Appeals' adoption of the Commission's approach in this action breached that guarantee to Transit.

C. The Commission's Post Hoc Rationalization Violated Due Process

In an obvious but misdirected attempt to avoid the retroactivity problem raised by perpetuating the invalidity of Order No. 773 under circumstances where it was superseded on October 18, 1968 by an unchallenged rate order, the Court of Appeals blindly adopted the Commission's conclusion that the subsequent rate orders were "incremental" to and "based on" Order No. 773. The Commission's post-hoc rationalization is precisely the type of arbitrary action this Court has previously warned against.

In *West Ohio Gas Co. v. Pub. Util. Comm'n*, 294 U.S. 79 (1935), this Court considered a challenge to the setting of utility rates by the Ohio Public Utilities Commission. The Commission intended to fix a schedule of charges such that West Ohio Gas would enjoy a net income of $11,391.39. In fixing rates to be effective during August 1929 through February 1933, the Commission

[17] *Potomac Elec. Power Co.*, 380 A.2d at 126; *Williams v. WMATC*, 415 F.2d 922 (D.C. Cir. 1968), *cert. denied*, 393 U.S. 1081 (1969).

ascertained gross income and operating expenses by confining itself to 1929 financial data even though "full and unchallenged" financial data for 1930 and 1931 was available. In holding such a decision to be violative of due process, the Court noted:

> We think the adoption of a single year as an exclusive test or standard imposed upon the company an arbitrary restriction in contravention of the Fourteenth Amendment and of "the rudiments of fair play" made necessary thereby. . . . The earnings of the later years were exhibited in the record and told their own tale as to the possibilities of profit. To shut one's eyes to them altogether, to exclude them from the reckoning, is as much arbitrary action as to build a schedule upon guesswork with evidence available.

Id. at 81-82.

Similarly, in the present case, the Commission and the Court of Appeals closed their eyes to the presumptively valid and "unchallenged" rate orders which superseded Order No. 773. As in *West Ohio Gas,* the superseding rate orders "told their own tale" as to the reasonableness of rates charged by Transit. By presuming, in the face of contrary evidence, that Order No. 773 served as a "base" for future rate orders, the Commission and Court of Appeals engaged in the precise type of arbitrary rate restriction found by this Court to contravene due process and "the rudiments of fair play." *Id.* at 81. *See also Bd. of Pub. Util. Comm'rs v. New York Tel. Co.,* 271 U.S. 23, 32 (1926) ("Profits of the past cannot be used to sustain confiscatory rates for the future."); *Potomac Elec. Power Co.,* 380 A.2d at 134 ("rate maker may not rely on out-of-date information when more recent actual experience . . . is available.").

The Commission and Court of Appeals' conclusion that the rate orders subsequent to Order No. 773 were merely "incremental" constitutes nothing more than a *post hoc* rationalization for retroactively invalidating the rate orders. There was no statement or assertion in any of the four superseding orders that the rates fixed by such orders were incremental or were not based on the most recent financial data before the Commission. A332-A485. Rather, each subsequent fare order represented, at the time of its issue, a reasonable charge for mass transit service. The Commission and Court of Appeals' simply conjured up the "incrementalism" rationale in an attempt to permit a retroactive attack on such rate orders long beyond the date that the statute of limitations would permit such attacks. *See* D.C. Code § 12-301 (1981). Such a due process violation cannot be upheld.

This Court has warned against this type of arbitrary action in *SEC v. Chenery Corp.*, 332 U.S. 194 (1947) and *Burlington Truck Lines Inc. v. United States*, 371 U.S. 156 (1962). In *Chenery*, this Court stressed the "fundamental rule of administrative law . . . . that a reviewing court, in dealing with a determination or judgment which an administrative agency alone is authorized to make, must judge the propriety of such action *solely by the grounds invoked by the agency.*" 332 U.S. at 196 (emphasis added).The same reasoning applies by analogy when as here, the rate orders subsequent to Order No. 773 have been retroactively modified on the basis of some element not announced in each order. Due process principles have been violated.

II.

The Court of Appeals Upheld the Confiscation of Property from Transit Without Due Process by Allocating to the Ratepayers the Gains Realized on Non-Depreciable Property

The Court of Appeals' incorrect allocation to ratepayers of the gain on non-depreciable assets transferred out of service disregards established precedents of this and other courts and ignores traditional principles of public utility regulation. Indeed, the Court of Appeals opinion is so contrary to established law and reason that it significantly threatens the legitimate expectations of all those who invest in public utilities such as Transit.

As Judge MacKinnon noted in his dissent below, the long-standing "practice in utility cases [is] to allocate gain or loss on nondepreciable assets to investors, rather than to consumers. . . . ." A229. In *Bd. of Pub. Util. Comm'rs v. New York Tel. Co.*, 271 U.S. 23 (1926), this Court enunciated the rule of law that *investors* in public utilities, rather than the utilities'customers, are the owners of the company's property. *Id.* at 32. In so holding, the Court explained the interrelationship between a public utility and its customers:

> Customers pay for service, not for the property used to render it. Their payments are not contributions to depreciation or other operating expenses, or to capital of the company. By paying their bills for service they do not acquire any interest, legal or equitable, in the property used for their convenience or in the funds of the company.

Id. This Court also noted that: "just compensation safeguarded to the utility by the Fourteenth Amendment is a reasonable return on the value of the property used at the time that it is being used for the public service". *Id.*

at 31. The Court of Appeals blinds itself to this important precedent and, as Judge MacKinnon aptly noted, simply "blazes its own trail.[18]" A230.

Further, as Judge MacKinnon recognized, the Court of Appeals unilaterally "rejected the unanimous decisions of expert regulatory agencies that have specifically relied on [this] Court's decision in *New York Telephone*." A230. The uniform result of administrative decisions within the District of Columbia is that allocation of gain in the disposition of non-depreciable assets inures to *investors*. *See DCC-I*, 485 F.2d at 795.[19] The reason that farepayers have not been given the benefit of the gain from non-depreciable property is that, unlike depreciable property, the farepayers have never paid for the use of the property.[20] The investors *necessarily* bear

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[18] *See also City of Lexington v. Lexington Water Co.*, 458 S.W.2d 778, 780 (Ky. 1970); *Philadelphia Suburban Water Co. v. Pennsylvania Pub. Util. Comm'n*, 58 Pa. Commw. 272, 427 A.2d 1244, 1246-48 (1981); *Boise Water Corp. v. Idaho Pub. Util. Comm'n*, 99 Idaho 158, 578 P.2d 1089, 1093 (1978).

[19] *See D.C. Transit Sys., Inc.* (Order No. 245), 48 P.U.R.3d 385, 399 (WMATC 1963). Holding that the utility's ratepayers were entitled to the gains on the sales of land, the Commission explicitly recognized that "[w]hile the ratepayers may have a claim to *depreciable property*, at least to the extent of the depreciation reserves, *no such claim can be directed to land.*" *Id.* (emphasis added). *See also D.C. Transit Sys., Inc.*, (Order No. 4577), 30 P.U.R.3d 405, 409 (D.C. Pub. Util. Comm'n 1959) (sale of land profits treated as "proper credit to earned surplus" with gains benefitting investors); *D.C. Transit Sys., Inc.* (Order No. 563), 63 P.U.R.3d 32, 34 (WMATC 1966) (same).

[20] The rationale underlying the rule that gain from the disposition of non-depreciable assets belongs to the utility's investors derives from the fact that investors bear the risk of loss. Unlike depreciable assets where the ratepayers maintain the shareholders' investment through the depreciation reserves and bear the risk of loss of obsolescence, non-depreciable assets, such as land, are not subject to depletion allowances and do not become obsolete. In the event that land is sold below cost, the risk of loss is borne by the investors. Accordingly, as Judge MacKinnon noted: "[c]ustomers have no interest in profits on dispositions of land, since they make no contribution to capital cost and have therefore not reimbursed investors for their capital outlay." A229-A230.

the burden and risk with respect to non-depreciable property and the only appropriate balancing of interests is to compensate investors for that burden. Farepayers should not be gratuitously benefitted by, and investors should not be impermissibly deprived of, the appreciation of Transit's non-depreciable property. Nevertheless, the Court of Appeals did precisely this by depriving Transit's shareholders of the benefits of their profitable investment in land.[21]

By retroactively reversing this uniformly adopted accounting method, the Court of Appeals and the Commission also violated procedural due process guaranteed by the Fifth Amendment. *See United States v. Macdaniel*, 32 U.S. (7 Pet.) 1, 14, 15 (1833); *Gelpcke v. City of Dubuque*, 68 U.S. (1 Wall.) 175 (1864); *Douglass v. County of Pike*, 101 U.S. 677 (1880); *Green County v. Conness*, 109 U.S. 104 (1883); *Edward Hines Yellow Pine Trustees v. Martin*, 268 U.S. 458 (1925).

In formulating its financial planning, Transit relied upon the consistently applied and generally accepted ratemaking principles that were applicable at the time of the transfers. It decided whether to retain these properties or sell them, whether to leave them vacant or rent

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[21] Furthermore, the Court of Appeals opinion denies Transit due process because it permits past profits to "sustain confiscatory rates of the future", a proposition that, until now, has been soundly rejected as violative of due process guarantees. *Newton v. Consol. Gas Co.*, 258 U.S. 165, 175 (1922); *Bd. of Comm'rs v. New York Tel. Co.*, 271 U.S. at 31. Transit "earned" income at the time it transferred land to non-operating status. The amount of that income was the appreciation over cost at the time of the transfer. Some of these transfers occurred as early as 1958. Yet the Court of Appeals has now said that in setting Transit's future rates in 1968 and again in 1970, the Commission should have credited as an offset to such future rates this income that Transit "earned" in prior years. To permit this holding to stand would be to emasculate due process protections to which regulated utilities have been historically and necessarily entitled.

them, and the extent to which debts should be incurred upon them as security, all based upon a set of established principles in effect at that time. It made decisions about its ability to expand operations and operating expenses based upon the fact that its earned surplus included gains on land it already had sold and would include gains on land it could sell. Similarly, investors and creditors made decisions based upon the same assumptions. Transit, its parent, its parent's more than 7,000 shareholders, and Transit's creditors were all entitled to rely upon these principles which had been approved by decisions of this Court and by numerous final rate orders of the Commission.

III.

The Court of Appeals Upheld the Confiscation of Property from Transit Without Due Process by Depriving Transit of the Market Value of Property When First Devoted to Public Service

Even if the appreciation in Transit's properties while in public service is attributable to the farepayers, Transit should have been allowed to retain the difference ($4,141,771) between the book value of the properties acquired from Capital at 11:55 p.m. on August 14, 1956 and the uncontested market value of those properties at the time they first were devoted to public use at 11:59 p.m. on August 14, 1956. Because Transit made a purchase at a price below market when it acquired the assets of Capital, that difference in value between book value and market value prior to the property being devoted to public use belonged to Transit's investors once Transit purchased and paid for the property. If Transit had closed its doors at 11:58 p.m. on August 14, 1956, after it acquired these properties, but before it devoted

them to public use, it would have been entitled to keep whatever it could get on the market for the properties it owned.

When Transit devoted such properties to public use, it booked the cost of the properties at prices not "anywhere near their true market value." *DCC-I*, 485 F.2d at 815. Transit introduced appraisals into evidence to show the market value of the properties when devoted to public service at 11:59 p.m. on August 14, 1956.[22] Using such information, the Commission recognized that using a "market-to-market" approach denied "Transit's investors the benefit of their bargain purchase" and recommended measuring the farepayer's restitution by comparing market value at the end with market value at the beginning of the property's useful life. A141-A142. This is what Transit suggested below but that suggestion was rejected by the Court of Appeals.

Consistent with due process, the farepayers cannot be entitled both to (1) the difference between the booked value and market value of the properties *before* devoted to public use; and (2) the subsequent appreciation of the assets during their tenure as operating properties. As this Court recognized in *Chicago M. and St. P. R.R. v. Minnesota*, 134 U.S. 418, 458 (1890):

> If the company is deprived of the power of charging reasonable rates for the use of its property, and such deprivation takes place in the absence of an investigation by judicial machinery, it is de-

[22] Of the $13,540,000 booked as the cost of Capital's properties, $1,884,584 represented the book value of the properties at issue in the remand proceedings. At the hearing before the Commission, Transit introduced uncontested evidence that the market value of those properties at 11:59 p.m. on August 14, 1956 was $6,026,355. It is the difference of $4,141,771 which Transit was deprived of by the "book-to-market" valuation measurement.

> prived of the lawful use of its property, and thus, in substance and effect, of the property itself, without due process of law and in violation of the Constitution of the United States; and in so far as it is thus deprived, while other persons are permitted to receive reasonable profits upon their invested capital, the company is deprived of the equal protection of the laws.

Id. at 458. See *generally* E. Nichols, *Ruling Principles of Utility Regulation: Rate of Return* 10-13 (1955). Depriving Transit's investors of the market value of the property prior to its devotion to public use, without compensation, is plainly confiscatory and violative of the Fifth Amendment to the Constitution. The Court of Appeals ignored this obvious result.[23]

In adopting the "book-to-market" approach, the Court of Appeals failed to recognize that the Compact itself provided that investors, having undertaken a risk of loss, would be entitled to recover a return on their investment:

> It is hereby declared as a matter of legislative policy that in order to assure the Metropolitan District of an adequate transportation system operating as private enterprises *the carriers therein*, in accordance with standards and rules prescribed by the Commission, *should be afforded the opportunity of earning such return as to make the carriers attractive investments to private investors*. As an incident thereto, the opportunity to earn a return of at least 6½ per centum net after

[23] In addition, Transit's suggestion of a use of a "market-to-market" method would provide a better approximation of real value, since book value is usually a poor indicator of an item's worth. *See generally* G. Johnson and J. Gentry, *Finney's Principles of Accounting*, 367, 372 (8th ed. 1980).

> all taxes properly chargeable to transportation operations, including but not limited to income taxes, on gross operating revenues, shall not be considered unreasonable.

74 Stat. at 1040-41 (emphasis added). This declaration adopted, nearly verbatim, the language used by Congress in 1956 when it adopted the Franchise Act granting Transit its franchise to operate a mass transportation system in the Washington Metropolitan Area. The Franchise Act contained the additional policy declaration that "Congress will maintain a continuing interest in the welfare of the Corporation and its investors." 70 Stat. at 599.

The Commission and Court of Appeals' actions in this case were entirely inconsistent with maintaining "a continued interest in the welfare of the Corporation and its investors." Instead, the Commission and the Court of Appeals deprived Transit's investors of part of the value of their property *prior to* its devotion to public service. Such a result should not stand undisturbed.

Conclusion

For the reasons set forth above, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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